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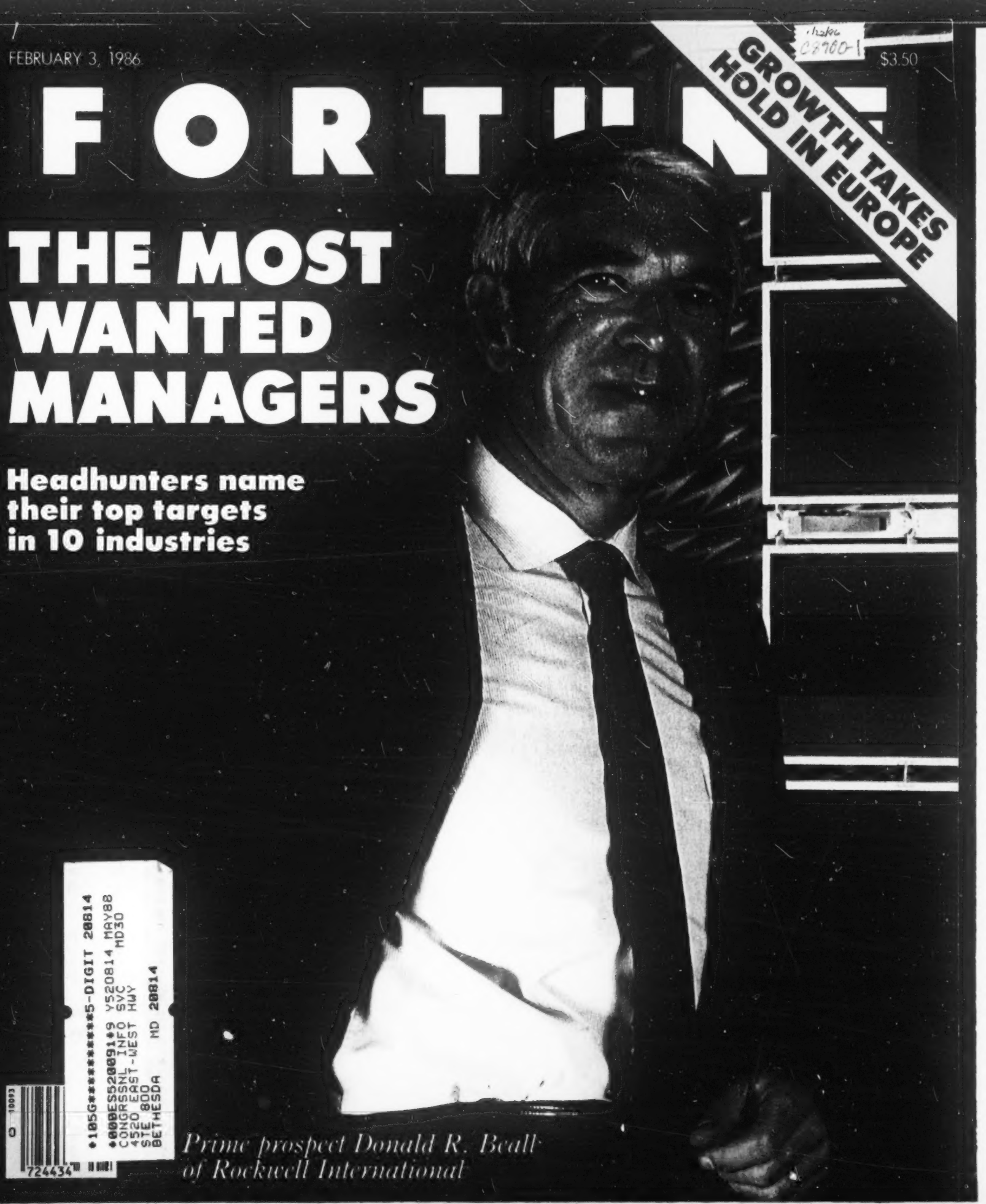
FORTUNE

GROWTH TAKES HOLD IN EUROPE

THE MOST WANTED MANAGERS

Headhunters name their top targets in 10 industries



Prime prospect Donald R. Beall of Rockwell International

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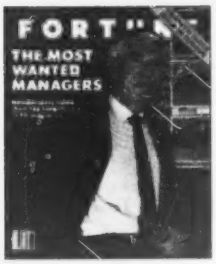

For the cover, Joyce Ravid photographed Donald R. Beall, the most wanted executive in the aerospace and defense industry. See page 18.

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NEWS/TRENDS

Yankee come home

■ Calling Libya "a threat to the national security and foreign policy of the United States," President Reagan severed virtually all economic ties and impounded Libyan assets in the U.S. Reagan cited "irrefutable evidence" of Libyan involvement in the recent terrorist attacks that claimed 19 lives in Rome and Vienna. His order bans all trade with Libya and forbids U.S. citizens to transact any business in the country, except for humanitarian or journalistic purposes.

The sanctions were largely symbolic. Previous embargoes have reduced U.S.-Libyan trade to a trickle. Five American companies—**Occidental Petroleum, Amerada Hess, Conoco, Marathon Oil**, and **W.R. Grace**—have minority oil holdings, and two engineering and construction firms—**Price Brothers** and **Brown & Root**—are working on a big desert irrigation project. Most were uncertain how much getting out would cost them, but all said they would comply. The executive order would also uproot roughly 1,500 U.S. citizens in Libya. Those who defy it could face prison sentences of up to ten years on their return home.

BRAD MARKEL—CAMI

President Reagan lashes out against Libya at his press conference.

Reagan's rhetoric found few answering echoes abroad. Japan said merely that it understood Reagan's views and would study the matter; European reactions were tepid, though Italy said it would suspend arms sales to Libya. European companies do a sizable business with Libya (see chart), and European governments have consistently opposed economic sanctions. West German government spokesman Friedhelm Ost sounded a common theme. Said he: "Past experience shows that sanctions, regardless of who imposes them, have never had the desired result and have often produced the opposite effect."

EDITOR *John Nielsen*
REPORTER *Andrew Evan Serwer*

	IMPORTS FROM LIBYA in millions	EXPORTS TO LIBYA in millions
U.S.	$9	$220
Italy		
W. Germany		
France		$233
U.K.	$187	$361
Japan	0	$455

SOURCE: INTERNATIONAL MONETARY FUND

Some links to Libya are stronger than others
The U.S. does less business with Qaddafi than its allies, some of whom depend heavily on Libyan oil. Figures are for 1984, the latest year available.

Instant exit from instant cameras

■ In a dramatic ending to a sad saga for a U.S. giant, **Eastman Kodak** is out of the instant photography business. A Washington appeals court refused to lift an injunction prohibiting Kodak from making or selling instant film or cameras. The injunction was issued last October, when a judge ruled that Kodak had infringed on seven **Polaroid** patents. Kodak is still appealing the verdict. But rather than cease operations temporarily and then reopen if a higher court rules in its favor, the company decided to shut the door forever on instant photography.

Kodak's potential losses could be enormous. It must write off capital equipment worth millions and transfer or dismiss at least 800 idled workers. It plans to give retailers credit for unsold inventories, and in an unusual move, it will allow customers to exchange their 16.5 million Kodak instant cameras (selling at discount for $20 to $65) for either one share each of Kodak common stock (recently selling at $47), a Kodak disk camera and film, or $50 in coupons good for Kodak products. But the biggest blow could come if Kodak loses the appeal. Should Polaroid win treble damages, the award could easily exceed $1 billion.

Instant photography has been a disappointing business for Kodak, accounting for only about 2% of sales. Polaroid controls three-quarters of the domestic market, which has shrunk more than 60% since its heyday in 1978. But there was bright hope for Kodak in technical applications of instant photography—in hospitals, for example, or in producing instant copies of video images—which already make up 40% of Polaroid's sales. Says Peter Enderlin, a security analyst for Smith Barney: "It's a very important and growing business. Polaroid could do very well there over the long run." Especially now that it has the business to itself.

Icahn's dubious win

■ Financier Carl C. Icahn finally won control of **Trans World Airlines** after a seven-month struggle and an 11th-hour wrangle with the pilots' and machinists' unions. Icahn's investment group is already the largest shareholder, with 48% of the 40.8 million shares outstanding. He was named chairman and

LOOKING AHEAD

GROWTH TAKES HOLD IN EUROPE

The coming year looks good. Consumers are poised to buy. German investors think the sky's the limit. In Italy even the Communists are tracking stocks. ■ *by Richard I. Kirkland Jr.*

WESTERN EUROPE increasingly has the look of a marathoner able to go the distance. With West Germany leading the way, business investment and consumer spending have kicked in just as export growth began to fade with the dollar's drop. The unemployment rate has finally begun to fall. Corporate profits are up and inflation down, propelling stock markets to new highs. In Milan, where prices on the *borsa* just about doubled in 1985, even the Communist party's official newspaper, *L'Unità*, has started printing daily stock quotes.

Best of all, European governments continue, slowly but steadily, to make painful structural adjustments that can put their economies on a higher growth path for years to come. After trailing the U.S. in 1983 and 1984, Europe pulled just about even last year, with an inflation-adjusted GNP growth rate of an estimated 2.4%. Forecasters think Europe can at least match that rate in 1986. If it does, Europe might ease ahead of the U.S., especially if the less optimistic predictions about U.S. growth prove true. The Reagan Administration is forecasting a robust 4% expansion for 1986; most economists are more pessimistic. FORTUNE's forecast, which is among the gloomier, projects real GNP growth in the U.S. of slightly less than 2%. Japan should still keep its edge over Europe, though it is expected to grow at a relatively sluggish 3.5% this year, compared with an estimated 5% in 1985.

Europe's progress is good news for the world economy. In its 1986 forecast, the Paris-based Organization for Economic Cooperation and Development (OECD) notes that the global recovery looks more sustainable than it did six months ago, and cites improving prospects in Europe as a major reason. With consumer demand strong, U.S. multinationals should find their European operations a boon again, particularly since earnings denominated in marks, francs, or lire are worth more than they were when the dollar was so muscular a year ago.

The new prosperity is spread unevenly. Swedes tightened their belts a bit as the country's growth rate slowed. Italian investors started the year feeling as bouncy as their stock market. But the boomiest mood is in West Germany. The country is enjoying a recovery whose balance is hard to beat—an inflation rate falling toward 1%, budget deficits steadily shrinking, and a big trade surplus coupled with increasing domestic demand. Most forecasters expect West Germany's real growth to average at least 3% this year, up from an estimated 2.3% in 1985. Economists at Commerzbank, the country's third-largest bank, and some others think the figure could reach 4%. The normally cautious Germans have turned almost giddy in their newfound sense that almost anything is possible. Deutsche Bank, for instance, swallowed the privately held Flick industrial empire in one $2-billion gulp and is now preparing to resell shares to the public.

The conservative coalition led by Chancellor Helmut Kohl is already feeling the political effects of the good news. For much of last year, polls showed Kohl far behind his Social Democratic rival. With elections only a year away, Kohl's coalition is now solidly in front.

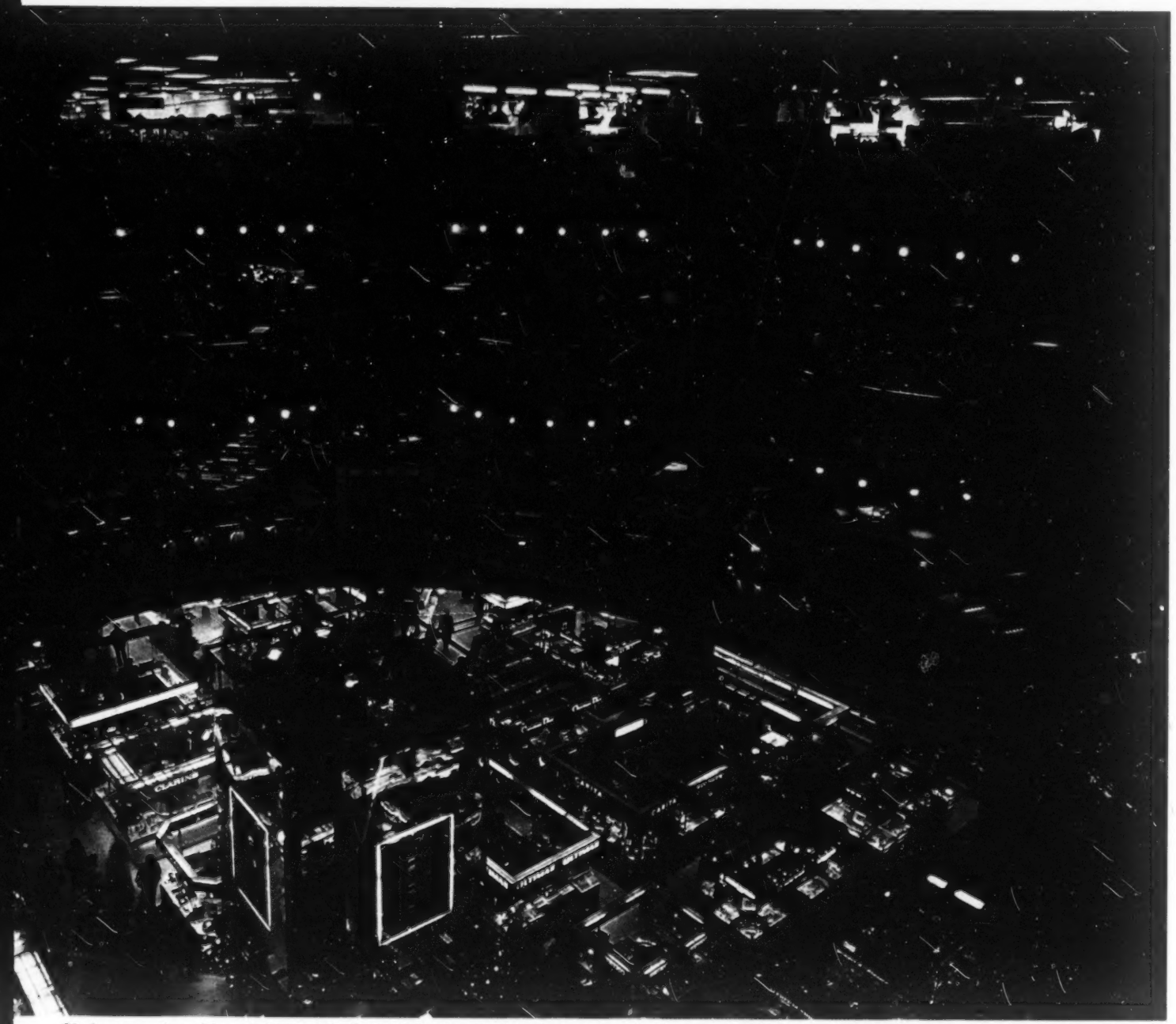
Europe's mood has changed markedly. "The syndrome of defeatism is gone," says Kaspar V. Cassani, head of $11-billion-a-year IBM Europe. Unbridled faith in the future is still a distinctly American state of mind. But yesterday's "Euro-pessimism" is giving way to confidence that a lot of old attitudes are gone. "Making a profit was often thought to be a crime," says Robert Studer, head of investment banking at Union Bank of Switzerland. "Now everyone, even the unions, wants to see companies make money."

Europe still labors under large handicaps.

A shopping spree *that got under way before*

PHOTOGRAPH BY RICHARD KALVAR—MAGNUM

RESEARCH ASSOCIATE *Nancy J. Perry*



Christmas—in evidence above at the Galeries Lafayette department store in Paris—should help propel the European economy all year long.

Tax rates are generally higher than in the U.S. Deregulation of airlines, trucking, and other forms of transportation has so far been a nonstarter. The web of restrictions that govern the hiring, firing, and paying of workers remains in many places. Employers are reluctant to take on new workers who would be hard to get rid of in a slump. Though the Common Market continues to take snail-paced steps toward creating a unified European market for manufactured goods, it still functions all too often as a subsidized farming cartel. The entry this winter of Spain and Portugal, two largely agricultural countries, is bound to make things worse. Weighed down with heavy outlays for industrial subsidies and entitlements such as health care and pensions, governments spend more than half of total Common Market output vs. about 35% in the U.S. (including state and local spending) and 30% in Japan.

But Europe has finally stopped piling on new burdens. Government spending as a share of the economy shrank slightly last year after rising for more than two decades. Common Market economists expect a further glacial contraction this year. Politicians have largely resisted pressure for new subsidies and new protectionist measures, despite stubbornly high unemployment. Says John Llewellyn, chief forecaster for the OECD: "A big part of the good news from Europe is that the bad things that could have happened haven't."

A particularly bad thing that happened far too often in the 1970s was pay hikes in excess of inflation. Breaking the upward spiral of labor costs has been the keystone of Europe's economic revival. Last year the rate of increase in European manufacturing wages fell from 7.3% to 6.5%, according to the OECD. Because of the drop in the infla-

tion rate, Common Market economists estimate that real earnings rose 1.1%. But a 2% increase in productivity safely outpaced the pay boosts, cutting unit labor costs.

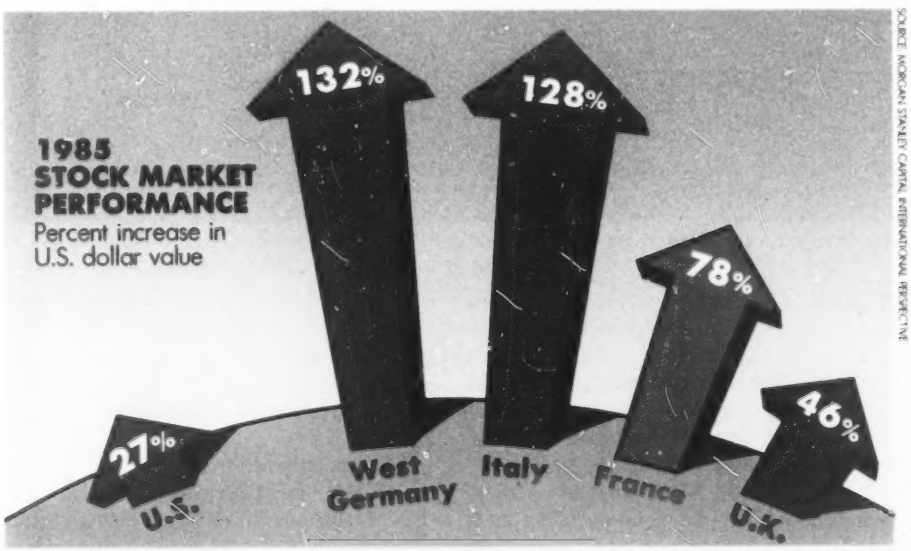
Most economists expect a repeat of that pattern in 1986, which means that the strengthening of European currencies against the dollar won't depress the competitiveness of European exports as much as it otherwise might. The risk of a wage explosion is greatest in Britain, where real wages rose over 3% last year and may climb even more than that in 1986, despite relative calm on the labor front. Both the Thatcher government and the Bank of England have begun chastising employers for granting what they consider unwarranted wage increases.

Fiscal policies across Europe remain relatively tight, while socialists and conservatives alike hew with the fervor of the converted to their newfound faith in deficit reduction. Suggestions from the Reagan Administration that Europe should achieve even faster growth by cutting taxes deeply and letting deficits creep up a bit are falling on deaf ears. Says Gilbert de Botton, head of London-based Global Asset Management, a highly rated money management firm: "European governments are determined to get off the toboggan ride of stop-go economic policies."

A further drop in Europe's inflation rate is almost certain. Because oil is priced in dollars, Europe didn't get much benefit from falling oil prices while the dollar rose against European currencies. The dollar began to drop last spring and got another push in September when U.S. Treasury Secretary James Baker III brought finance ministers from Europe and Japan to New York's Plaza Hotel to plan coordinated intervention. At the time Europeans were paying 10% more for a barrel of oil than at the end of 1982. Today Europeans pay 10% less than in 1982, thanks to the dollar's post-Plaza decline.

Assuming no change from year-end exchange rates or oil prices, the OECD projects that Europe's Big Four—Britain, West Germany, France, and Italy—will lop 1.5 percentage points off the 5.3% inflation rate they averaged in 1985. If oil prices and the dollar keep drifting down, as seems likely, European inflation and interest rates could drop even more and investment and real incomes would rise sharply.

With lower inflation putting money in their pockets, European consumers are off on their biggest buying binge in more than five years. In West Germany, for example, the rate of growth of consumer spending in 1986 is expected to be more than double that of last year. To cash in on this shopping spree, London brokerage houses are touting the shares of retailers including France's Carrefour, which owns a string of supersize supermarkets; West Germany's Hussel Holding, whose specialty shops peddle everything from perfume to sporting goods; and Darty, a French electronic appliance chain.



Blasting Off From Europe's Bourses

If U.S. stocks hit the moon last year, some of Europe's reached Mars. The chart computes prices in dollars, which exaggerates their rise because European currencies strengthened. In local currencies West German shares climbed 81% and Italy's 98%, while France's rose 40% and the U.K.'s 18%.

Some governments will also allow workers to take home a bit more pay this year. In West Germany the Kohl government has approved a modest two-step income tax cut. The first decrease will keep about $4.5 billion in taxpayers' pockets through a variety of deductions and rate cuts. The cut in 1988 will amount to about $4 billion. French workers have received tax breaks worth about $6.5 billion, courtesy of Socialist President François Mitterrand, whose term in office expires in 1988. Further cuts could be forthcoming if, as expected, French voters return control of the legislature to the right in the March election. In Britain, Prime Minister Margaret Thatcher, who must call an election sometime before June 1988, wants income taxes lowered this year, though falling North Sea oil prices are battering government revenues. London stockbrokers are betting on a tax cut totaling around $3 billion.

FOR EUROPEAN INDUSTRY, stronger domestic demand should ease the pain of shrinking profit margins on exports. Soaring profits in banking, electrical equipment, and chemicals, among other industries, have already boosted corporate earnings in Europe to the highest levels since the 1973 OPEC oil shock. After years of big losses, Italian chemical giant Montedison expects to report what it calls "a substantial profit" for the year just ended. Security analysts think the company will earn around $60 million. Thyssen, the West German industrial conglomerate, earned an estimated $250 million in the fiscal year that ended last September, up sharply from the year before. The company is paying a dividend for the first time in three years. West German automakers made money coming and going, thanks to strong demand at home and abroad. Analysts expect Daimler-Benz to report a 30% increase in profits to more than $500 million for 1985. Volkswagen could net as much as $250 million, more than double 1984's profit.

Rising profits have sparked a much needed European capital investment boom. In the Common Market last year, capital spending grew more than twice as fast as the year before, after adjustment for inflation. Says Brendan Brown, an international economist with the London brokerage firm of Phillips & Drew: "A year ago I don't think anyone believed investment spending would have the force we're seeing now." Among Europe's major economies, capital spending climbed 12% in Italy and 11% in West Germany. It

Booming capital investment *has workers at Gildemeister, a West German computerized machine toolmaker, scrambling to meet demand.*

ought to increase 7% to 9% in both countries this year.

As in past European recoveries, companies continue to buy robots and other equipment that improves productivity while adding no new jobs. But for the first time in years part of capital investment is going into job-creating production capacity. In West Germany manufacturing employment is growing again after a ten-year decline. It is also on the rise in the Netherlands, Denmark, and Norway.

Employment growth has been particularly buoyant among electrical equipment manufacturers, which are riding the global trend toward merging metal bending with microelectronics. Orders are up 70% over last year at Thyssen's machine tool subsidiary. In a recent survey 40% of West German electrical companies said they planned to expand capacity, vs. 6% three years ago.

The OECD, which as recently as September was predicting another small increase in European unemployment, now forecasts that the unemployment rate will stop growing this year for the first time since 1973. More optimistically, Hans Mast, chief economist for Credit Suisse, Switzerland's third-largest bank, projects an actual fall in Western European unemployment from 11.3% to 10.5%.

International competition is forcing rapid deregulation of Europe's stock markets (FORTUNE, October 14). More vigorous markets should gradually lower Europe's high cost of capital, particularly for the small firms that tend to create the most jobs. In Britain venture capital investment, spurred by various tax breaks, has soared from about $20 million in 1979 to over $300 million last year, when more than 175,000 new businesses started up.

BRITAIN and West Germany lead the way in making Europe's labor markets less rigid. By encouraging unions to take strike votes by a secret ballot of all members rather than by a show of hands at mass meetings, the Thatcher government undercut the clout of some of Europe's most bloody-minded labor barons. In December the Kohl government proposed controversial legislation that would cut off unemployment payments to workers laid off by strikes they did not call. Outraged union leaders protest that this would strain worker solidarity and make strikes harder to sustain.

Europe's steady improvement has cheered even one of its more prominent pessimists. Several years ago Herbert Giersch, president of the Kiel Institute for World Economics, coined the word "Eurosclerosis" to describe Europe's economic malady of high taxes, heavy government spending, overregulation, and rigid labor rules. Now he is increasingly persuaded that the disease is in remission, assuming governments stay on their present course. "In terms of invigorating its growth, Europe is still five to ten years behind the U.S.," Giersch says. "But over the longer term I can see Europe catching up."

There seems little chance that voters will soon turn again to the kind of interventionist governments that so stifled European industry. In recent elections in Belgium and Norway, voters opted to keep conservatives in power. In France conservatives appear likely to march back into office with a vision known as *l'état minimum*, or minimal government, a far cry from the statism of their old hero Charles de Gaulle. Even Margaret Thatcher, who launched Europe's turn to the right in 1979, looks less vulnerable than she did a year ago. If political leaders can continue to deliver on their pro-market promises and the world economy avoids major calamities, Europe's three-year-old recovery may just run and run and run.